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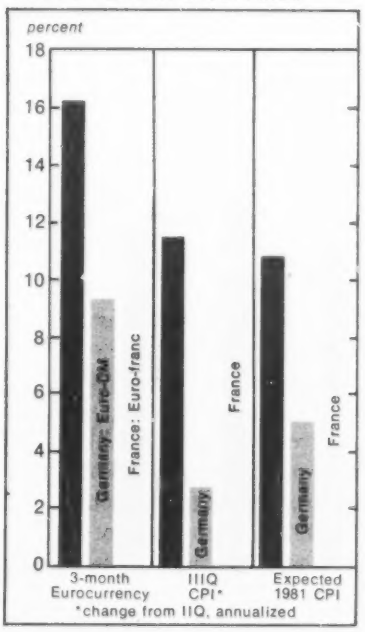
Europe's Restrictive Policies Dampen Prospects for Recovery

Evidence of economic slowdown throughout Europe is now well established. Industrial production in the United Kingdom began its decline in the third quarter of 1979; it now stands 8% below its second-quarter 1979 peak. German industrial production peaked in the first quarter of 1980 and has been declining ever since. And data suggest that Italy and France entered recessions in the second quarter of 1980.

The continent-wide slowdown has been accompanied by a generalized easing of inflationary pressures. The rate of consumer price inflation has been running in the 5%-6% range in Germany. In the United Kingdom, the annualized monthly rates for July, August, and September were in the 10% area, and French inflation has stabilized in the low double digits. These improvements, however, have brought little relief for the currently high level of European interest rates. Short-term money market rates in Germany are 3-4 percentage points above the current inflation rate and the expected rate for 1981. In the United Kingdom, current short-term rates of 16% provide significant expected real returns, with the 1981 inflation rate likely to be only 10%-12%. In Italy and France, the degree of monetary stringency is less apparent in terms of expected real yields, but both the lira and the franc have been strong against the German mark in the European Monetary System, suggesting that their policies have been at least as restrictive as those in Germany.

Selected European inflation and interest rates



The recent behavior of the European monetary aggregates further illustrates the degree of monetary tightness now prevailing in Europe. Germany's narrowly defined money supply, M_1, is less than 3% above its year-ago level. Similarly, M_1 in the United Kingdom has grown by less than 5% in the last year, and French M_1, by 7%. (Broader monetary aggregates have grown much faster, but these include some money market instruments that bear interest at competitive levels. Such instruments are chosen by investors over bonds when restrictive monetary policy produces an inverted yield curve, and are consequently less useful indicators of the tenor of monetary policy.)

The surprisingly restrictive nature of European monetary policy is in no small way the result of a similar policy being pursued in the United States. Still, the consequences for economic growth will not be avoided, and European recovery in 1981 stands to be very sluggish. Even if the currently restrictive monetary policies are eased by spring, it will be difficult for Western Europe to achieve a combined real economic growth rate of more than 1.5% in 1981.

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Market anticipates further U.K. interest rate cuts soon.

Ever since the 1% cut in the United Kingdom's minimum bank lending rate in July 1979, the market has anticipated further rate declines in the face of a deepening domestic recession. The slowdown has certainly worsened—September industrial production was down 89.3% from its year-earlier level and the volume of retail sales had fallen to its 1972 level—but the money supply has continued to surge; sterling M_3 in October stood 18.1% above its October 1979 level. Since the authorities have given priority to limiting monetary growth to 11% per annum, they have been unwilling to reduce interest rates until a more favorable money growth trend is seen. But as the recession deepens, the government will come under increasing pressure to lower interest rates; and this has led to the market's expectation of an early rate reduction. Meanwhile, the large interest-rate differential favoring sterling has kept the currency strong, boosting its trade-weighted index (1971=100) to a peak of 80.2, the highest level since April 1975.

New Belgian coalition government also committed to fiscal restraint.

Belgium's 1981 budget, originally announced in August, contained proposals to raise indirect taxes and reduce social security expenditures by 15 billion francs, helping cut the public-sector borrowing requirement to 242 billion francs next year from BF 254 billion in 1980. The proposals to reduce social security spending ran into parliamentary difficulties and were the proximate cause of the downfall of Wilfred Martens' third coalition. The new coalition government of Mr. Martens still envisages a deflationary budget, with provisions for wage restraint in the private sector supported by legislation, a reduction in government officials' salaries, a cut in social security outlays, and a job protection program supported by tax incentives and grants to small and medium-sized companies. Although no figures on the magnitude of the expenditure cuts have yet been released, public investment is expected to decline in real terms. Official forecasts, however, still expect a small increase in real GDP in both 1980 and 1981.

Portugal awaits presidential election with weakening economy.

The general election win of Sa Carneiro's center-right democratic alliance represents one step toward the political stability that Portugal needs for its long-term economic health. The presidential election set for December 7, however, will be equally significant. If the incumbent General Eanes is reelected, the government could have problems implementing its program of economic liberalization. In the interim, the authorities must continue grappling with a rising oil bill, high inflation, and depressed world markets. The current-account for the period January through May 1980 was in deficit by $800 million—compared with a gap of $34 million for all of 1979—even with a strong tourist season and large inflows of workers' remittances. A deficit of $800 million for the full year appears likely. Domestic inflation subsided to a year-over-year rate of 16% in August, down from 23% in March, following the escudo's revaluation. But rapid monetary growth and the likelihood of reflationary policies are expected to return the inflation rate to more than 20% in early 1981.

Malaysian economy hurt little by worldwide recession.

The Malaysian economy has been little touched by the worldwide recession. Real GDP growth this year is projected at 8%, roughly the same as in 1979. Although the consumer price inflation rate will climb from last year's 3.6%, the rate should not exceed 7%-8%. On the external front, the current-account balance is expected to show a small surplus after posting a surplus of almost $1.4 billion last year. Export volume is off slightly in rubber and tin, but palm oil exports have risen sharply. Oil production will be down to an average of about 250,000 barrels per day this year, versus 283,000 bpd in 1979, as government policy is aimed at restraining output to extend reserves. Nonetheless, net oil export earnings will be up as a result of higher prices. The export outlook for the next few years is highly encouraging. The natural gas project at Bintulu will begin shipping LNG in 1983, with full-scale production of 6 million tons annually expected by 1986. The plantation sector is likely to continue to thrive, and Malaysia will remain the world's leading exporter of natural rubber, palm oil, and tin and become an important exporter of coconut products and cocoa.

Australian agricultural outlook darkened by severe drought.

Severe drought in eastern and parts of western Australia will undermine the Australian agricultural sector's performance in fiscal 1980/81 (ending June 30). In October, the Australian Bureau of Agricultural Economics forecast a wheat harvest of less than 10 million metric tons—40% below last fiscal year— and a 21% decline in overall crop production. Cattle and sheep farmers have also been hit hard. The volume of wool output in fiscal 1980/81 is projected to be down 4% and beef and veal output, down 2%. Higher prices will provide partial compensation to farmers for declines in production, and so far it appears that enough wheat will be available to meet Australia's export commitments. The drought will, however, retard real economic growth and dampen Australia's hopes for a continued major expansion in agricultural exports.

Large oil export earnings buoy Trinidad and Tobago's sluggish economy.

Higher world petroleum prices are the lynchpin of Trinidad and Tobago's recent export strength. With oil accounting for 90% of total exports, foreign earnings in the first half of 1980 were up 67% above receipts in the year-earlier period. The higher oil earnings are almost entirely the result of price rises, since the volume of petroleum exports has increased by only 6% this year. The added earnings are buoying an otherwise sluggish economy. A gradual decline in crude oil output and problems with agricultural crops held real GDP growth to only 3% last year, and economic advance in 1980 is expected to be only marginally faster. Moreover, rising import prices and strains created by the massive industrial investment program now under way have lifted the annualized inflation rate to nearly 19% this year from 15% at end-1979. These pressures have engendered restraint in fiscal and monetary policies. The government, however, has not softened its commitment to building a substantial industrial sector based on the country's ample supplies of natural gas.

Dominican Republic pursuing restrictive policies to check worsening payments balance.

The government of the Dominican Republic has since mid-year pursued restrictive policies to halt a rapidly deteriorating trend in the country's international payments balance. Imports during the first half were 53% above their year-earlier level, and official foreign-exchange holdings in June had declined to about one month's import cover. In response, increases in government spending are being contained, primarily by a freeze on salaries and hiring. This, combined with anticipated revenue increases, should help lower the budget deficit to about 2.5% of GDP from 6% in 1979. On the monetary front, several measures have been taken to reduce domestic liquidity. These include freezing credit issued through the central bank discount facility at its end-1979 level, imposing a 50% reserve requirement on special funds previously exempt, and establishing a 100% reserve requirement on the amount of letters of credit issues for imports not subject to prior deposits. The central bank has also expanded the list of items for which it will no longer provide foreign exchange at the official rate and for which a prior import deposit is required. These measures are expected to limit the total import bill to $1.4 billion in 1980. With export earnings projected at $1.1 billion, a trade deficit of $300 million is thus expected this year, up from the $225-million shortfall of 1979.

Coffee pact endangered by worldwide glut.

The newly formed price-stabilizing pact between the world's coffee producing and consuming nations faces a stiff test in the months ahead as huge excess supply continues to dominate the international coffee market. The U.S. Department of Agriculture estimates that the 1980-81 world coffee crop will total 80.1 million bags, roughly the same as in 1979-80. Only about 25% of the crop is expected to be consumed by the producing nations, which will leave an estimated 60.6 million bags available for export. Members of the International Coffee Organization, in an effort to stabilize coffee prices within a range of $1.15-$1.55 per pound, agreed last month to a quota system that initially limited the volume of coffee exported worldwide to 57.4 million bags. Export demand in the 1980-81 season is expected to be well below this level. The tremendous glut is likely to keep coffee prices near the lower end of the targeted price range and may also spur producers to violate the agreement in search of markets for their surpluses.

Interest Rate Decline in 1981?

Interest rates in both money and capital markets have been exceptionally volatile in recent weeks, as financial markets have been unusually sensitive to any surprises in reported economic and financial data. While this volatility suggests that markets are highly uncertain regarding the near-term course of interest rates, there are indications that most investors anticipate a significant decline in short-term interest rates in 1981.

Since late October, daily interest rate and bond price movements have been quite pronounced. For example, during the first 19 days of November, the average absolute daily change in the 90-day Treasury bill rate was over 30 basis points. Over this same period, the average absolute daily change in 20-year Treasury bond prices was almost 1½ percentage points, or $1.50 per $100 face value. Moreover, intra-day variations in rates and prices were often even more pronounced. Such behavior is reminiscent of the volatility experienced last winter when interest rates rose to record levels.

While the market's perception of the near-term outlook for rates continues to fluctuate wildly, the current pattern of interest rates on 90-day Treasury bill (T-bill) futures contracts suggests that most investors expect that short-term interest rates will drop in 1981. For example, the rate quoted on a futures contract calling for the delivery of 90-day T-bills on June 18, 1981 was about 12% on November 19. This compares with the current rate on T-bills for immediate delivery of about 13¾%. This spread between the current bill rate and the June 1981 futures rate, which is the widest it has been since April, implies that futures market participants expect bill rates to drop significantly by mid-1981.

The yield curve in the Eurodollar market also suggests that most investors in that market expect short-term interest rates to fall in 1981. For example, the rates on three-month, six-month, and one-year Eurodollar deposits on November 20 were about 16½%, 16%, and 14¾%, respectively. If investors as a whole do not believe that three-month Eurodollar deposits will fall sometime in 1981, then a significantly higher expected rate of return could be obtained by investing in three-month Eurodollar deposits and rolling them over than by investing in one-year deposits.

Although markets apparently anticipate a 1981 rate decline, however, it may not necessarily materialize. Both the T-bill futures market and the shape of the Eurodollar yield curve have a number of times in the last two years pointed to market expectations of a rate decline that in fact never materialized. It is still useful, however, to have some idea of what the markets are betting on.

Rising Prices Will Boost Farm Income

There are signs that the decline in net farm income that has continued since mid-1979 is over, but not without inflicting heavy costs. Lower farm income has led to decreased investment and lower agricultural productivity, putting upward pressure on retail food prices. This has been compounded by continued large increases in labor, transportation, and marketing costs. Consequently, consumer food prices may rise faster in 1981 than their 10% clip this year.

Net farm income was $31.0 billion in 1979, second only to record earnings in 1973. But in the first half of 1980, farm income fell to an annual rate of $24 billion. As incomes declined, farmers cut back on expenditures for tractors and other machinery. Adjusted for inflation, such spending dropped more than 25% between the second quarter of 1979 and the second quarter of 1980.

The drop in net farm income was the result of a combination of sharply higher marketing costs and weaker receipts from livestock production in the face of oversupply. Responding to the high prices in 1978 that were associated with cattle herds being rebuilt, hog and poultry producers increased their output. But as more pork and chicken made its appearance on the market beginning in 1979, prices fell, eroding farm incomes.

These declines lasted until the summer of 1980, when severe heat and drought reduced the supply of poultry by about 10% and ended the production gains for pork. Although the heat and drought depressed livestock farmers' production, however, they had a positive impact in spurring price rises. Indeed, prices have reached levels that now make increased production profitable again; they should also be high enough to compensate for the lower output in the near term. The adverse weather conditions also reduced crop yields, but again, sharply higher prices should do much to ease the pain.

The U.S. Department of Agriculture estimates that net farm income stabilized in the second half of 1980. Farm investment has also apparently stabilized. If the increase in farm income for 1981 is as high as the 20%-25% that the USDA projects, spending for farm equipment could also be expected to show a good gain.

Any reduced price pressures from gains in efficiency as investment increases, however, are likely to be more than offset by rapidly rising costs of getting the food from the farm to the table. The farm value accounts only for about 40% of the retail cost of food. The remaining 60% is attributable to marketing costs, such as transportation and packaging. Such costs have increased by 15% in the past year. Thus, although farm price increases in the past year were moderate, retail prices still rose by 10%. As the recent increases in the farm value get passed forward to retailers and marketing costs continue to escalate rapidly, consumers are very likely to see food prices rise more quickly in the months remaining in 1980 and through the first half of 1981.

Europe, Canada & U.S. Bimonthly Survey of Business and Finance

COUNTRIES	CURRENT BUSINESS CONDITIONS	INDUSTRIAL OUTPUT		GNP IN 1979		BALANCE OF PAYMENTS					MONEY AND BANKING							COUNTRIES
											12-month changes				central bank rate	exchange rate in U.S. dollars		
		latest data	12-month change	in billions of dollars	real growth	latest data	reserves (less gold) in $ million	12-month change	months of imports covered	use of IMF credit, millions of dollars	current influences on payments	latest data	consumer prices	latest data	money supply(M_1)	November 19, 1980		current monetary conditions	
Austria	Economy signaling slowdown in wake of German slump; mildly restrictive 1981 budget proposed.	Apr.	+ 6.8%	67.9	+ 9.5%	Sept.	4,739	+ 22.0%	2.3	0	Current-account gap of 42 billion schillings foreseen for 1980.	Sept.	+ 6.9%	July	+ 9.5%	6.75%	.0740	Monetary conditions continue restrictive.	Austria
Belgium	Budget for 1981 likely to be deflationary despite rising unemployment; industrial output remains flat.	July	— 3.1%	112.4	+ 3.5%	Sept.	8,262	+ 40.8%	1.3	0	Current-account deficit of more than $6 billion officially forecast for 1980.	Sept.	+ 6.8%	June	— 1.6%	12.00%	.03274	Interest rates ease as pressure on franc subsides.	Belgium
Britain	No sign yet of recession's end; Sept. industrial output down 9.3% and Oct. unemployment at 7.8%.	Sept.	— 9.3%	399.6	+ 0.9%	Sept.	21,559	+ 8.5%	2.2	828	Trade and current-account balances now showing large surpluses.	Oct.	+ 15.4%	Aug.	+ 4.0%	16.00%	2.3800	Money growth continues rapid, but early MLR cut rumored.	Britain
Denmark	Latest figures confirm that GDP growth rate will fall this year, perhaps by 1%, from 1979 pace.	June	+ 6.0%	65.0	+ 3.5%	Sept.	3,166	— 6.1%	2.0	0	Higher oil bill will enlarge 1980 trade gap, despite economic slowdown.	Aug.	+ 11.2%	June	+ 4.0%	12.00%	.1712	DM weakness in EMS allows small interest-rate reduction.	Denmark
Finland	Economic output continues to grow, promising the largest 1980 GDP increase in all Europe.	July	+ 8.6%	40.5	+ 6.7%	Sept.	1,942	+ 0.3%	1.5	87	Jan.-Sept. cumulative trade deficit was 5.1 billion markkaa.	Aug.	+ 12.3%	July	+ 9.7%	9.25%	.2655	Monetary policy continues restrictive.	Finland
France	Business surveys indicate pronounced downturn in demand.	Sept.	— 5.2%	569.4	+ 3.2%	Sept.	27,686	+ 75.0%	2.5	0	Export orders down; current-account gap to top FF 30 billion in 1980.	Sept.	+ 13.6%	Aug.	+ 9.0%	9.50%	.2270	Exchange rate firm; interest rates decline.	France
Germany	Output and orders continue to fall; five institutes now forecast zero economic growth in 1981.	Sept.	— 4.8%	761.7	+ 4.4%	Sept.	49,152	— 6.1%	3.2	0	Current-account shortfall of 30 billion DM expected in 1980.	Oct.	+ 5.3%	Aug.	+ 1.9%	7.50%	.5267	Interest rates stay high in face of weak DM.	Germany
Ireland	Recession worsening; retail sales and economic output down 3.5% and 1.5% from year ago.	May	+ 3.9%	14.7	+ 1.9%	Sept.	2,583	+ 22.7%	2.9	0	Current-account deficit now beginning to narrow slightly.	Aug.	+ 18.8%	Aug.	— 1.0%	13.50%	1.9550	Interest rates ease; huge budget gap a limiting factor.	Ireland
Italy	Industrial production drops sharply in August; leading indicators point downward.	July	+12.5%	324.2	+ 5.0%	Sept.	21,717	+ 16.1%	2.7	0	Current-account deficit could exceed $10 billion this year.	Oct.	+ 20.5%	May	+17.2%	16.50%	.001105	Credit remains highly restrictive.	Italy
Netherlands	Broadly neutral 1981 budget proposed; economy likely to show virtually no growth in '80 and '81.	Aug.	— 2.0%	148.8	+ 2.3%	Sept.	11,460	+ 46.1%	1.7	0	Current-account gap of 4.5 billion guilders likely in 1980.	Sept.	+ 6.9%	July	+ 5.6%	8.00%	.4860	Interest rates ease with guilder strong in EMS.	Netherlands
Norway	Despite oil production, the economy is set to slow over the next twelve months.	Aug.	— 4.8%	44.5	+ 3.2%	Sept.	5,057	+ 19.2%	3.7	0	Current account for Jan.-July posts surplus of 2.7 billion kroner.	Sept.	+ 12.7%	July	+ 7.2%	9.00%	.1999	Financial market forces may be given somewhat greater play.	Norway
Portugal	Confidence increases somewhat following general election.	Feb.	+16.0%	19.7*	+ 3.2%	Aug.	871	— 3.7%	1.2	155	Tourist season set a record.	Aug.	+ 16.0%	June	+24.9%	18.00%	.0193	Credit relatively restrictive.	Portugal
Spain	Economic activity still weak but could be reaching turning point.	Feb.	+ 8.5%	196.0	+ 1.5%	Aug.	13,104	+ 1.7%	4.6	270	Current-account deficit in 1980 could reach $5 billion.	July	+ 14.8%	July	+ 9.5%	8.00%	.0130	Credit still generally available.	Spain
Sweden	Orders from abroad falling rapidly; GDP unlikely to grow by more than 0.5% in 1981.	Aug.	+ 1.0%	100.6	+ 3.5%	Sept.	3,575	— 1.3%	1.3	0	Trade deficit for Jan.-Oct. was 11 billion kronor.	Sept.	+ 15.0%	Dec.'79	+16.3%	10.00%	.2325	Ma growing at 8.7% annualized, slower than domestic prices.	Sweden
Switzerland	Continued real economic growth seen for short term; less encouraging outlook for 1981.	June	+ 8.5%	98.0	+ 0.7%	Sept.	14,206	— 5.3%	4.7	0	Current-account gap of SF 2 bn. likely in '80, despite strong export growth.	Oct.	+ 3.6%	July	—11.4%	3.00%	.5855	Monetary policy continues restrictive.	Switzerland
Turkey	Economy continues in recession; some supply bottlenecks are easing.	n.a.	—	69.3	+ 1.7%	Aug.	1,186	— 1.9%	2.6	1,159	Import growth accelerates as more foreign finance becomes available.	Apr.	+124.9%	Nov.'79	+55.5%	10.75%	.001137	Monetary conditions continue restrictive.	Turkey
Canada	New national energy program aims at 50% Canadian ownership of oil and gas production by 1990.	Aug.	— 3.2%	222.3	+ 2.7%	Oct.	2,727	— 7.0%	0.6	0	Merchandise trade surplus increases significantly.	Oct.	+ 10.9%	Sept.	+ 5.8%	12.67%	.8569	Interest rates rise moderately.	Canada
United States	Renewed economic decline foreseen for winter months.	Oct.	— 4.4%	2,368.8	+ 2.3%	Sept.	11,826	+ 61.4%	0.6	0	Trade account improves sharply.	Sept.	+ 12.7%	Sept.	+ 4.8%	12.00%	—	Discount rate raised to 12%.	United States

*1978

World Interest Rates

market rates of Nov. 19, 1980; bond yields as of Nov. 14, 1980

in percent per annum	U.S.	Canada	Britain	Belgium	France	Germany	Italy	Netherlands	Switzerland	Japan
Central Bank Discount Rate	12.00 penalty-lg. bks. 14.00	12.67	16.00	12.00	9.50	7.50	16.50 penalty rate 19.50	8.00	3.00	7.25
Day-to-Day Money	16.75 Nov. 20	10.50	15.375	8.90	9.75	8.90	17.625	9.125	2.50	9.3115
Treasury Bills 91-day, Middle Rates	13.68	12.60	14.3125	12.50	12.44 one-year	n. a.	15.80 101-day	no dealing	no market	6.375 2-month
Commercial Paper prime, 3-month, asked	13.75 finance paper	12.90 finance paper 15% tax w/h	13.61	11.60 Certified	11.375 Interbank	no market	no market	no market	no market	not traded
Bankers' Acceptances 3-month, asked	15.00	12.65 15% tax w/h	15.0625	11.60 Certified	not traded	9.90	20.70	no market	4.50	no market
Government Bonds Long-term, new and old issues, average yield	12.45	13.40	12.78	10.613 20% tax w/h	13.74	8.73	16.18	10.44	4.69	8.50
Industrial Bonds prime, long-term, new and old issues, average yield	12.85 Aa Industrials	13.75	13.69	15.64	14.64	9.00	16.30	11.31	5.71	7.23
Bank Short-Term Rate to Best Borrowers (prime rate)	16.25	13.75	17.00	15.75	13.85	11.50	21.00 ⅛ quar'ly fee on outstdng.	11.00	5.50	7.50
Bank Time Deposits 3-month	15.25 Cert. of Dep.	11.25	15.4375	12.50	11.50	9.30	10.75	9.875 large deposits	5.4375 residents only	6.00 20% tax w/h
Eurocurrencies 3-month, asked	15.875	no market	15.6875	no market	11.125	9.25	no market	9.75	5.5625	no market
Exchange Rates—in U.S.$ rates floating against the $	—	.8569	2.3800	.03274	.2270	.5267	.001105	.4860	.5855	.004707
Forward Exchange Cover 3-month, in percent p.a. D = discount, P = premium	—	4.00 *P*	.50 *P*	3.375 *P*	4.875 *P*	6.50 *P*	2.00 *D*	6.125 *P*	10.50 *P*	5.625 *P*

Eurodollar Deposits
(London, interbank, bid)
Nov. 20

7-day	16.0625
1-month	16.75
3-month	16.4375
6-month	15.875

International Arbitrage
(3-month, hedged) + *in favor of U.S. dollars*

U.S.-U.K. Treasury Bills	− .93
U.S.-Canada Treasury Bills	−2.38
U.S.-Canada Finance Co. Paper	−2.97
Eurodollars-U.K. Local Auth. Deposits	+ .125

Eurobonds
(average yield on recent straight debt issues)

U.S. Dollar Bonds	
7 yrs. and under	13.25
Over 7 yrs.	13.50
DM Bonds	
7 yrs. and under	9.375
Over 7 yrs.	9.50

Gold Price
London afternoon fixing
629.75
(per fine ounce)

The above interest rate quotations refer to the past week and may not be construed as offers by The Chase Manhattan Bank. The quotations for Bank Short-Term Rate to Best Customers, while including customary commissions, reflect neither possible other fees nor varying compensating balance requirements.

Current economic indicators of major industrial countries

	U.S.	Canada	Britain	France	Germany	Italy	Switzerland	Japan
Consumer prices*	12.7 (Sept.)	10.9 (Oct.)	15.4 (Oct.)	13.6 (Sept.)	5.3 (Oct.)	20.5 (Oct.)	3.6 (Oct.)	8.9 (Sept.)
Industrial production*	−4.4 (Oct.)	−3.2 (Aug.)	−9.3 (Sept.)	−5.2 (Sept.)	−4.8 (Sept.)	12.5 (July)	8.5 (June)	5.9 (Sept.)
Trade balance† *(billions of local currency units)*	−$1.64 (Sept.)	C$0.57 (Sept.)	£0.46 (Oct.)	FF4.46 (Oct.)	DM1.63 (Sept.)	−Lit.2,420 (Sept.)	−SF0.79 (Oct.)	¥423 (Sept.)
Money supply (M_1)*	4.8 (Sept.)	4.9 (Aug.)	4.0 (Aug.)	9.0 (Aug.)	1.9 (Aug.)	17.2 (May)	11.4 (July)	2.0 (Aug.)
Velocity of money (M_1)*	3.5 (June)	10.7 (June)	11.7 (Mar.)	n. a.	5.8 (June)	4.3 (Mar.)	n. a.	5.7 (June)
Reserves minus gold *($ million, change from previous month)*	310 (Sept.)	−313 (Sept.)	−720 (Sept.)	110 (Sept.)	1,736 (Sept.)	−604 (Sept.)	1,953 (Sept.)	720 (Sept.)

* Percent change from 12 months earlier.

† Figures are only for the month indicated

Latin American Investment Outlook Bright

The nations of Latin America and the Caribbean are undoubtedly among the world's most promising markets for investment in the coming decades. Their aggregate economic growth rate is expected to continue rapid, and they possess large and expanding domestic markets, elements that have historically proven to be prime magnets for foreign direct investment. Indeed, the *Global 2000 Report*, just released by a special inter-agency group within the U.S. Government, projects that the population of the Latin American region will increase by 2.7% per year over the next two decades, and that real GNP in the period 1985-2000 will rise by 4.5% per annum, on average, the highest of all the world's major regions. *Global 2000* also notes that although many developing countries will show little real per capita gains by 2000, several countries in Latin America are projected to advance significantly over the next 20 years.

Aside from the two key attractions of a growing market and fast-paced economic growth, Latin America and the Caribbean also possess abundant and diverse natural resources, which are largely untapped. Moreover, as such traditional industries as auto production and steel come under more severe competitive pressures in the older industrialized nations, the developing world in general—and Latin America in particular—will offer strong inducements for the establishment of new plants and facilities to serve not only expanding local markets, but also as export platforms for both the developed and other developing-country markets.

Expanding market and vigorous growth

Encompassing a vast land mass, Latin America and the Caribbean constitutes a substantial market of 350 million people. Total GDP of the 39 nations of Latin America and the Caribbean was approximately $600 billion in 1979, or $1,714 per capita. Real per capita GDP, a prime determinant of the attractiveness of investment oriented to the local market, is rising rapidly for a large number of these countries. Argentina, Venezuela, Trinidad and Tobago, and the Bahamas are seeing their per capita GDPs approaching or exceeding $4,000, and the majority of the remaining Latin American nations lie in the middle-income grouping among developing countries.

The Latin American-Caribbean area experienced inflation-adjusted economic growth of nearly 7% per annum in the past decade, well above the 3.5% annual average for the United States and 4% for the OECD nations. Indications are that the 1980s will see the pattern repeated, with Latin America and the Caribbean recording average annual GDP growth of 5%-6%. Such an economic growth rate is quite favorable when compared with average annual growth of some 3%-4% foreseen for the industrialized West and Japan during the next decade.

A wealth of natural resources

The Latin American region is a veritable treasure-house of natural wealth, holding particularly great promise for investors seeking to develop oil, gas, mineral, oceanic and agricultural resources. In terms of mineral reserves, Chile and Peru are major repositories of copper; Jamaica is one of the world's principal sources of bauxite; Brazil has vast iron ore deposits still to be developed; and coal is just beginning to be mined in Colombia. Mexico, Trinidad and Tobago, Venezuela, Ecuador, Peru, and Argentina are endowed with significant deposits of oil and gas. And the region's great hydroelectric power potential is underscored by the construction now under way at the Itaipu hydroelectric plant on the Parana River bordering Brazil and Paraguay. When its almost 13,000-megawatt capacity is installed, the Itaipu plant will be the largest such facility in the world.

RESERVES OF SELECTED MINERALS IN THE LATIN AMERICA-CARIBBEAN AREA

	Major Reserves (% of World Total)	Major Producers (% of World Total)
Bauxite	Surinam (11) Jamaica (5)	Jamaica (14) Surinam (6) Guyana (4)
Bismuth	Latin America (21)	Latin America (48)
Columbium	Latin America (45)	Brazil (7)
Copper	Chile (19) Peru (8)	Chile (13) Peru (5)
Iron Ore	South America (19)	Brazil (9)
Molybdenum	Chile (16)	
Nickel	Cuba (24)	
Silver	Mexico (13)	Mexico (15)
Tin	Bolivia (10)	Bolivia (13)
Tungsten	Bolivia (3)	

Source: World Bank and U.S. Bureau of Mines

Latin America's long-term agricultural prospects are also encouraging. The *Global 2000 Report* projects that the nations of this region will see their total food production increase by more than 184% between 1970 and 2000, with consumption rising by a more moderate 165%. The Report predicts that Latin America will be the only developing region where average per capita food consumption in the year 2000 will be more than 20% above the U.N. Food and Agriculture Organization's minimum caloric standard.

Latin American Investment Outlook Bright *(continued from page 7)*

Foreign investment on the rise

Many of Latin America's industrializing nations will undoubtedly attract a large share of the world's industry in the coming decades because of their large and well-trained labor forces; expanding technological base; ample financial intermediaries; and their generally more accommodating and pragmatic attitude to foreign investment.

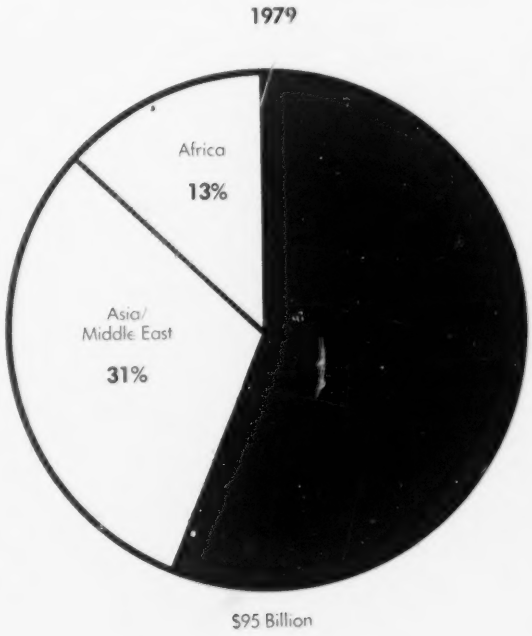
Moreover, as comparative advantages are eroded in the more mature industrialized nations, investors will be motivated to invest more heavily in such semi-industrialized nations as Mexico, Brazil, and Argentina, which have already established a variety of new industries. The world automotive industry is a prime illustration. As profitability has plunged in many industrialized-nation producers, major investments have been funnelled to Mexico, Brazil, Argentina, Colombia, Peru, and Venezuela. Other good candidates for a shift to the newly industrialized nations include the electronics, chemicals, steel, assembly, shipbuilding, and food processing industries.

The largest single foreign investor in Latin America is clearly the United States. The region was the recipient of $37 billion of U.S. investment, or 19% of total U.S. foreign investment, as of end-1979. More significantly, U.S. investment in Latin America at end-1979 came to 77% of total U.S. investment in the developing regions of the world, far surpassing investment in Africa and Asia. Responding to the attraction of a growing class of middle-income consumers, nearly all of recent U.S. manufacturing investment in the developing world has gone to Latin America. In fact, Latin America is keeping pace with Europe as the locus of major new U.S. investments. Since 1977, U.S. investment in Latin America has grown by 31%, compared with the 33% gain in U.S. investment in Europe during the same period.

Foreign investment in the Latin American-Caribbean area, however, is not only a U.S. franchise. In the last decade, European and Japanese firms have penetrated the region to a significant degree. Indications are that German and Japanese investment in the region has doubled in the last 10 years. In fact, total foreign direct investment by the industrialized nations in the Latin American-Caribbean area now represents 56% of all developing-region investment, with 31% going to the Middle East and Asia and 13% to Africa.

The most important Latin American markets for foreign investment have been Brazil and Mexico. As of end-1979, U.S. direct investment in Brazil was $4.4 billion, some 27% of the $16 billion of all foreign investment in that country. German investment in Brazil totaled $2.5 billion, and Japanese holdings were roughly $1.5 billion. And while U.S. investment in Brazil rose by 16% between 1970 and 1979, German firms expanded by 18%. European and Japanese foreign direct investment is also rising in Mexico, challenging the United States' traditionally preeminent role. Of the $6.8 billion of total foreign private investment in Mexico in 1979, the U.S. share was 70%, compared with an 81% U.S. share in 1971.

Leading Region For Foreign Investment In Developing World



Source: United Nations and Chase Economics Group

Increased competition for financial services

Reflecting the burgeoning investment opportunities in the Latin American-Caribbean region, competition for financial intermediaries is heating up. The large U.S. banks are expanding the scope of their activity, and other international banks are beginning to establish themselves in the region. Local Latin American banks are adding to the competition by establishing offices abroad and participating in international credits. And such international multilateral institutions as the World Bank and the Inter-American Development Bank will play an increasingly important role as providers of official credits. Thus, the expectation of adequate financial resources will help drive the engine of economic development as both local and foreign investors tap the vast economic potential of Latin America in the coming decades.

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